

No. 18,835 ✓

IN THE
United States Court of Appeals
For the Ninth Circuit

MARIA TERESA CRUZ SEGUI, as next friend
on behalf of DIGNA LUZ ORTIZ, an infant
and HECTOR LUIS ORTIZ, an infant,
Appellants,

vs.

RUTH SNOW BURNS O'ROURKE and
JOHN P. O'ROURKE,
Appellees.

APPELLANTS' OPENING BRIEF

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vs.

RUTH SNOW BURNS O'ROURKE and
JOHN P. O'ROURKE,
Appellees.

APPELLANTS' OPENING BRIEF

I

JURISDICTIONAL STATEMENT

This is an appeal from a final judgment of the United States District Court for the Southern District of California (Tr. 57-58), dismissing the complaint (Tr. 2-6) filed by Appellants, Plaintiffs below, against Appellees, Defendants below, for failure to state a claim upon which relief may be granted. The jurisdiction of the District Court was based upon diversity of citizenship under 28 U.S.C.A. § 1332. The jurisdiction of this Court is based on 28 U.S.C.A. § 1291.

II

STATEMENT OF THE CASE

On December 3, 1959, the United States District Court for the District of Puerto Rico entered a judgment (Tr. 8-13) in favor of Appellants herein, Plaintiffs below, against the corporation Snow Lines, Inc., for damages in the sum of \$20,000.00 plus costs for the wrongful death of the Appellants' father as caused by the negligence of Snow Lines, Inc.¹

The corporation Snow Lines, Inc. was duly organized and existed under and by virtue of the laws of

¹In its findings of fact and conclusions of law the Court found that Snow Lines, Inc. was the owner of a certain vessel known as the M/V Leda I, and that the corporation chartered, operated, managed, controlled, provisioned, manned, supplied and was in possession and control of said vessel. On March 17, 1954, Genaro Ortiz Esperanza, Appellants' deceased father, was employed by Snow Lines, Inc. aboard the vessel, and while he was attempting to carry out orders of the Master of the vessel to release a mooring line, the vessel, by reason of the negligence of corporation Snow Lines, Inc., its agents, servants or employees, was caused to collide with the dock, pinning the decedent between the vessel and the dock, thereby causing the decedent to sustain serious and severe injuries which resulted in his death. The Court further found that the injuries sustained by the decedent and his resulting demise were directly caused by the failure of the corporation Snow Lines, Inc., its agents, servants or employees, to provide a seaworthy, safe vessel and appliances and crew, and to keep the same in a seaworthy condition, and that the corporation failed, neglected and refused to supply the decedent with immediate and proper medical care, treatment, medication and nursing services which were reasonably necessary under the circumstances as a result of which his injury was caused to become more severe, aggravated and prolonged and to result in his death. The Court determined that Appellants herein, the recognized minor children of the decedent in whose behalf the action against Snow Lines, Inc. was brought, suffered damages in the amount of \$20,000.00 as a result of the death of their father, and their consequent loss of his support, maintenance, love, care and affection, their expectation of inheritance, and their great mental anguish (Tr. 9-12).

the Commonwealth of Puerto Rico (Tr. 2, 9-10). It was originally incorporated on June 2, 1952, and its principal office was established in San Juan, Puerto Rico. The incorporators were Ruth Snow Burns, nineteen shares, John P. O'Rourke, nineteen shares, Vicente M. Ydrach, one share, and Walter L. Cox, one share. Vicente M. Ydrach, the attorney who organized the corporation, Snow Lines, Inc., and Walter L. Cox, one of the above-named original incorporators of Snow Lines, Inc., had resigned from and severed all connection with said corporation prior to the time Appellants' cause of action against the corporation for the death of their father arose, and prior to the time judgment was entered in their favor against the corporation on December 3, 1959 (Tr. 55).

Ruth Snow Burns O'Rourke and John P. O'Rourke were therefore the sole Directors and Shareholders of the corporation at all times relevant to the prior action against the corporation in the United States District Court of Puerto Rico and to the controversy which is the subject of this Appeal.

The sole asset of the corporation Snow Lines, Inc., was the vessel M/V LEDA I. On or about April 1, 1954, fourteen days after Appellants' deceased father sustained his injuries while working aboard said vessel, which injuries resulted in his death due to the negligence of Snow Lines, Inc., and therefore fourteen days after Appellants' rights as creditors arose against the corporation, the ship M/V LEDA I was conveyed by the Defendants John P. and Ruth Snow Burns O'Rourke, directors of Snow Lines, Inc., to one

Jose Oller, Jr. for the sum of \$17,000.00, which amount was distributed by and between John P. and Ruth Snow Burns O'Rourke, making such distribution as Directors and receiving as Shareholders the total assets of the corporation thereby distributed (Tr. 46-47).

John P. and Ruth Snow Burns O'Rourke thereafter, and prior to the time the action was filed by Appellants in the District Court of Puerto Rico to seek damages for the wrongful death of their father, left the Commonwealth of Puerto Rico, and were not therefore available to be served with process and brought under the jurisdiction of that Court. The corporation, Snow Lines, Inc., has never, since that time, had any assets, engaged in business or maintained any place of business, or had any designated agent in the Commonwealth of Puerto Rico, and has not kept books or filed annual reports with the Secretary of the Treasury or the Secretary of State, as required under the laws of Puerto Rico. 3A Laws of Puerto Rico, Title 14, Private Corporations, Chapter 113, Section 2301.

The corporation Snow Lines, Inc., has never been formally dissolved by statutory proceedings as prescribed under the corporation law of Puerto Rico,² nor has its legal existence expired by any limitation of its term of existence or by forfeiture. While its corporate existence has not been terminated as a matter of law, however, the informal liquidation accom-

²3A Laws of Puerto Rico, Title 14, Private Corporations, Chapter 110, Sections 2003, 2010, 2012.

plished by John P. and Ruth Snow Burns O'Rourke in the sale of its sole and therefore its total assets, the abandonment of its corporate activities, and the distribution of its property between themselves as shareholders, has resulted in its practical or *de facto* dissolution.

In their informal disposal of the corporate property, distribution of the proceeds and consequent termination of the corporate business, the Appellees, as the corporation's sole Directors and Shareholders, failed to take the proceedings prescribed by law for the protection of the corporation's creditors. Because of the informal liquidation of the corporation Snow Lines, Inc., accomplished by John P. and Ruth Snow Burns O'Rourke, and the unauthorized return of the corporation's entire capital to themselves as shareholders, Appellants have not been able to satisfy the judgment of December 3, 1959, against the corporation Snow Lines, Inc.

On December 3, 1962, Appellants, Plaintiffs below, filed a Complaint in the District Court of the United States for the Southern District of California against Snow Lines, Inc., Ruth Snow Burns O'Rourke, John P. O'Rourke, Vicente M. Ydrach, and Walter L. Cox, Defendants, seeking to recover the amount of the judgment debt in the amount of \$20,000.00 from John P. and Ruth Snow Burns O'Rourke and other relief (Tr. 2-6). A certified copy of the Findings of Fact, Conclusions of Law and Judgment of the United States District Court for the District of Puerto Rico, filed and entered on December 3, 1959, in the prior

action against Snow Lines, Inc., was filed with the Complaint (Tr. 8-15).

On February 21, 1963, Appellees, Defendants below, Ruth Snow Burns O'Rourke and John P. O'Rourke, filed Notice of Motions pursuant to Rule 12b(1) and (6) for an order dismissing the action on the ground that the Court lacked jurisdiction over the subject matter and that the Complaint failed to state a cause of action upon which relief could be granted against said Defendants (Tr. 17-21).

On March 25, 1963, Appellants, Plaintiffs below, moved the Court for an order dismissing Defendants Snow Lines, Inc., Vicente M. Ydrach and Walter L. Cox, respectively, as parties defendant, on the ground that said parties had no real interest in or control over the subject matter of the controversy (Tr. 54-55).

A hearing was held in the District Court for the Southern District of California on Appellees' motion to dismiss; both Plaintiffs and Defendants were represented by counsel (Tr. 36). On the basis of the oral argument on March 25, 1963, and various memoranda submitted by Plaintiffs and Defendants (Tr. 24-36, 37-39, 45-53), the matter was submitted to the Court (Tr. 36), and on May 15, 1963, the Court filed its decision granting the Motion of Defendants John P. O'Rourke and Ruth Snow Burns O'Rourke to dismiss the Complaint as to them without leave to amend. The Court also approved and signed the Motion of Plaintiffs to dismiss as to the Defendants Snow Lines, Inc., Vicente M. Ydrach and Walter L. Cox (Tr. 56). Judgment was entered accordingly on June 4, 1963,

dismissing the action on the merits and with prejudice as to Defendants John P. O'Rourke and Ruth Snow Burns O'Rourke for failure to state a claim on which relief can be granted, and dismissing the action voluntarily as to all other Defendants (Tr. 57-58).

Notice of Judgment was mailed by the Clerk of the United States District Court for the Southern District of California on June 4, 1963 (Tr. 60), and on July 3, 1963, Appellants filed with that Court a Notice of Appeal to the United States Court of Appeal for the Ninth Circuit from that part of the Final Judgment entered on June 4, 1963, which dismissed the action on the merits and with prejudice as to Appellees Ruth Snow Burns O'Rourke and John P. O'Rourke (Tr. 62).

III

SPECIFICATION OF ERROR

Appellant has specified the following point on appeal:

The District Court erred in dismissing the complaint for failure to state a claim on which relief can be granted.

IV

ARGUMENT

I. THE ACTION WAS INSTITUTED IN THE COURT BELOW WITHIN THE PERIOD OF THE APPLICABLE STATUTE OF LIMITATIONS.

The District Court granted the motion of Defendants John P. O'Rourke and Ruth Snow Burns O'Rourke to dismiss Appellants' complaint without leave to amend as to them for failure to state a claim upon which relief can be granted (Tr. 57-58). In their statement of Points and Authorities, upon which the motion to dismiss was based, Appellees alleged that "[t]he theory of the complaint based upon negligence and alter-ego fails to state a cause of action against these defendants [Ruth Snow Burns O'Rourke and John P. O'Rourke] as it is barred by the statute of limitations" (Tr. 20).

Appellants asserted in their complaint, however, no "theory of the complaint based upon negligence," as contended by Appellees in the motion to dismiss, which would bar this action, as further contended by Appellees, under Section 340 of the California Code of Civil Procedure, which provides that an action for the death of a person caused by the wrongful act or neglect of another must be brought within a one year period of limitation. Appellants' earlier action in the District Court of Puerto Rico sought and resulted in a judgment awarding damages for the wrongful death of their father under the provisions of the Act of Congress approved June 5, 1920, known as the Mer-

chant Marine Act, amendatory to the Act of Congress known as the Seaman's Act of 1915, and by virtue of Section 20 of the latter Act, 46 U.S.C.A. § 688, which provides for recovery for injury to or the death of seamen. That section incorporated a three year limitation period. *Engel v. Davenport*, 271 U.S. 33 (1926).

The action brought by Appellants in the District Court of Southern California did not seek to establish the Appellees' personal liability for the wrongful death of the Appellants' deceased father, but sought to hold Appellees personally liable as directors and shareholders for the amount of a debt of the corporation Snow Lines, Inc., which debt arose out of the judgment of the United States District Court of the District of Puerto Rico entered on December 3, 1959. Their personal liability is imposed by statute and is based also on the fraudulent conduct of Appellees. The action is therefore within the purview of California Code of Civil Procedure, Section 338, which provides a three-year period for commencing such actions. Section 337.5 prescribes a ten-year period for commencing an action upon a judgment or decree of any court of the United States.

And insofar as the action arose in Puerto Rico, and therefore might be barred under the California law if barred by reason of the limitation period under Puerto Rican law, California Code of Civil Procedure Section 361, the action was instituted in the District Court for the Southern District of California within the period of limitations provided under the law of Puerto Rico.

Section 2202 of Chapter 112, Title 14, Private Corporations, 3A Laws of Puerto Rico (1962), provides as follows:

“(a) When the officers, directors or stockholders of any corporation, shall be liable to pay the debts of the corporation, or any part thereof, any action to enforce such liability shall be a class action for the benefit of all creditors to which the corporation if in existence shall be a party.

“(b) No suit shall be brought against any officer, director or stockholder for any debt or liability of a corporation, of which he is an officer, director or stockholder, until judgment be obtained therefor against the corporation, nor after three years from the date of such judgment and any such officer, director or stockholder may set up any defense which the corporation might have asserted against such debt or liability. This subsection (b) shall not apply to suits brought against officers or directors of a corporation in dissolution or liquidation for maladministration of their duties under chapter 110 of this subtitle.”

Insofar as the liability alleged in Appellants' complaint arises under the statutory laws of Puerto Rico, the period of limitations imposed by the above-quoted statute, attaching the obtaining of a judgment against the corporation as a condition to the personal liability of corporate officers, directors and shareholders, is likewise applicable, and this action has been instituted within the prescribed period.

The California statute of limitations applicable to actions brought to enforce liability arising under for-

eign statutes is similar to Section 2202 of the Puerto Rican Law of Private Corporations, providing that such actions must be brought within three years after the liability was created, and the statute begins to run in bar of an action to enforce the personal liability of stockholders only after judgment has been given against the corporation and there exist no corporate assets from which to satisfy it. California Code of Civil Procedure, Section 359; *Bank of North America v. Rindge*, 57 Fed. 279 (1898); *Spencer v. Anderson*, 193 Cal. 1, 222 Pac. 355, 357 (1924).

II. THE COMPLAINT SETS FORTH FACTS SUFFICIENT TO STATE A LEGAL CLAIM AGAINST APPELLEES.

A. The complaint is sufficient as tested by the requirements of the Federal Rules of Pleading.

In testing the sufficiency of a complaint upon a motion to dismiss for failure to state a claim under Rule 12(b)(6) of the Federal Rules of Civil Procedure, 28 U.S.C.A., the allegations of the complaint should be viewed in a light most favorable to the plaintiff, assuming all well-pleaded facts to be true and indulging in all inferences which reasonably may be drawn therefrom. *Rennie & Laughlin, Inc. v. Chrysler Corporation*, 9 Cir., 242 F.2d 208 (1957).

In a recent case the United States Supreme Court, which seldom has to deal with matters of mere procedure, has put its full approval on the well-established standard, repeated in countless cases:

“In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.” *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

Further discussing the principle that the purpose of pleading is to facilitate a proper decision on the merits by the trial Court after a hearing on the proof, the Court stated in *Conley* that

“... [T]he Federal Rules of Civil Procedure do not require a claimant to set out in detail the facts upon which he bases his claim. To the contrary, all the Rules require is a short and plain statement of the claim that will give the defendant fair notice of what the plaintiff’s claim is and the grounds upon which it rests. . . . Such simplified ‘notice pleading’ is made possible by the liberal opportunity for discovery and the other pretrial procedures established by the Rules to disclose more precisely the basis of both claim and defense and to define more narrowly the disputed facts and issues.” 355 U.S. at 47-48.

This Court has also recently taken an opportunity to “reaffirm” its views on the granting of a motion to dismiss, in its opinion in *Rennie & Laughlin, Inc. v. Chrysler Corporation*, *supra*, 242 F.2d at 213:

“... As stated in *Gruen Watch Co. v. Artists Alliance*, 9 Cir., 191 F.2d 700, 705,

‘On occasion motions to dismiss supply a useful technique for the prompt disposition of suits,

and the Federal Rules of Civil Procedure which permit judgment on the pleadings are useful indeed. But it must be borne in mind that in many a suit such a motion cannot take the place of submission of evidence and of findings of fact and conclusions of law.'

Nor is a motion to dismiss the only effective procedural implement for the expeditious handling of legal controversies. Pretrial conference; the discovery procedures; and motions for a more definite statement, judgment on the pleadings and summary judgment, all provide useful tools for the sifting of allegations and the determination of the legal sufficiency of an asserted claim. The salvaged minutes that may accrue from circumventing these procedures can turn to wasted hours if the appellate court feels constrained to reverse the dismissal of an action. That is one of the reasons why a motion to dismiss is viewed with disfavor in the federal courts. Another is the basic precept that the primary objective of the law is to obtain a determination of the merits of any claim; and that a case should be tried on the proofs rather than the pleadings. *DeLoach v. Crowley's Inc.*, 5 Cir., 128 F.2d 378, 380."

- B. The facts alleged in the complaint were sufficient to notify appellees of the essence of the claim against them.**

The complaint before the Court below alleges (Tr. 2-13) essentially the following:

On December 3, 1959, in the United States District Court for the District of Puerto Rico plaintiffs below obtained a judgment in their favor against the corporation Snow Lines, Inc., for the sum of \$20,000

plus costs by virtue of a complaint claiming damages for the death of the plaintiffs' father, caused by the negligence of Snow Lines, Inc. Defendants below, Ruth Snow Burns O'Rourke and John P. O'Rourke, were alleged to be the sole stockholders, officers and directors in that corporation as to which facts were alleged which show it to have been *de facto* dissolved subsequent to the time appellants' cause of action arose.

It was further alleged by Appellants in their complaint filed below that Appellees had sold the sole known asset of the corporation, a ship known as the M/V LEDA I, "thereby rendering said corporation hopelessly insolvent for the sole and deliberate purpose of defrauding appellants herein, who are judgment creditors of said corporation," and that they have done so "to the prejudice of its creditors and to the plaintiffs in particular," and that they have unlawfully distributed between themselves the proceeds from the sale of the property which constituted the entire amount of assets of the corporation, "thereby rendering said corporation insolvent in that it did not have and does not have sufficient assets to pay its liabilities or discharge its debts which were then due and payable" and which payment "was not otherwise provided for."

- C. It does not appear to a certainty that the appellants would not be entitled to relief under any set of facts which could be proved in support of the claim pleaded.

The purpose of the complaint was to hold Appellees Ruth Snow Burns O'Rourke and John P. O'Rourke

personally liable, as the sole stockholders, officers, and directors of a *de facto* dissolved corporation which served at all times only as their “alter ego” and business conduit, and as sole holders of the unlawfully distributed assets of the insolvent corporation, for a judgment debt of the corporation in favor of Appellants. There are several theories upon which such personal liability may be based, and the allegations of the complaint were sufficient to found the basis for the Appellants’ claim for relief against the Appellees.

The Appellants did not attempt in their complaint, as Appellees contended in their motion to dismiss, to assert for the first time the negligence of the Appellees and to seek a judgment of the court below awarding damages therefor. Such action was pursued against the corporation Snow Lines Inc., in the United States District Court for the District of Puerto Rico and resulted in the award of a judgment to the Appellants against said corporation in the amount of \$20,000 plus costs.

The action was then merged in the judgment which judgment gave rise to a new cause of action which is that brought in the Court below against the individual Appellees as officers and directors and as stockholders of the corporation Snow Lines, Inc. The rights of the Appellants against the Appellees, as directors and shareholders, did not arise until they had first obtained a judgment against the corporation upon which execution could not be levied, but the right which thereupon arose was one solely against the individual Appellees in their aforesaid capacities as

directors and shareholders of the corporation. It is a right which exists by virtue of the judgment rendered against the corporation but independent of the rights of the corporation itself which were merged in the judgment.

The sole asset of the corporation Snow Lines, Inc., was the vessel M/V LEDA I. It was aboard that vessel that on or about March 17, 1954, the Appellants' deceased father sustained severe injuries which resulted in his death, which injuries and his consequent demise were directly caused by the negligence of Snow Lines, Inc. On or about March 17, 1954, therefore, Appellants' rights as creditors arose against the corporation, even though their claim was contingent upon a judicial award. The relation of creditor and debtor arises in tort cases the moment a cause of action accrues and a claim exists by reason of which the creditor is or may become entitled to the payment of money. *Hansen v. Cramer*, 39 Cal.2d 321, 245 P.2d 1059 (1952); *Adams v. Bell*, 5 Cal.2d 697, 56 P.2d 208 (1936); *Freeman v. La Monte*, 148 C.A. 2d 670, 307 P.2d 734 (1957); *Cioli v. Kenourgios*, 59 Cal.App.690, 211 Pac.838 (1922). A corporation cannot by divesting itself of all its property leave remediless the holder of a claim in tort. *Pierce v. United States*, 255 U.S. 398, 402-03 (1921).

The conveyance of the ship M/V LEDA I by Appellees was generally alleged in the Complaint filed in the Court below. In support of that allegation, Appellants can prove that on or about April 1, 1954, the ship M/V LEDA I was conveyed by defendants,

John P. and Ruth Snow Burns O'Rourke, directors of Snow Lines, Inc., to one Jose Oller, Jr., for the sum of \$17,000.00, which amount was distributed by and between John P. and Ruth Snow Burns O'Rourke making such distribution as directors and shareholders and thereby receiving as shareholders the total assets of the corporation.

1. *Appellants as creditors of the corporation Snow Lines, Inc. have a direct right of action under common law principles against Appellees Ruth Snow Burns O'Rourke and John P. O'Rourke for their unlawful actions in disposing of the entire corporate property and distribution of the proceeds between themselves as shareholders without provision for and to the prejudice of its creditors.*

A private corporation, in the absence of statute, may, under some circumstances, dispose of all its property by authority of its Directors or by vote of the majority of its Shareholders and divide the proceeds among its Shareholders, but only if its creditors are provided for and are not prejudiced thereby. *Bancroft v. Taylor*, 91 Fed.2d 579; *Calman v. Guaranty Security Corporation*, 271 Mass. 533, 171 N.E. 830, 834.

The liability of directors for declaration of dividends or distribution of assets when the payment thereof reduces the capital stock at a time when the capital of the corporation is impaired or the corporation is thereby rendered insolvent, provided the directors act in bad faith or are guilty of gross negligence or inattention, is a principle existing at common law

and is subject to an equitable remedy. *Aiken v. Peabody*, 7 Cir., 168 F.2d 615, 617 (1947); 12 Fletcher, *Cyc. Corp.* (Perm. Ed.), Section 5431.

If a solvent, going corporation divests itself of its assets by distribution among its shareholders, creditors and all others holding claims may sue the directors and shareholders under the theory that assets in the amount of the outstanding claims are impressed with a trust in favor of the creditors and may thus be followed into the hands of the shareholders. *Pierce v. United States*, 255 U.S. 398 (1921); *Bankers Trust Company v. Hale and Kilbourn Corporation*, 84 F.2d 401, 403 (1936); *Saracco Tank and Welding Company, Ltd. v. Platz*, 65 C.A. 2d 918, 150 P.2d 918, 924 (1944); Ballantine on Corporations, Sections 301, 318, pp. 7, 9-10, 732-33 (Rev. Ed. 1946).

It is well-settled that the officers and stockholders of a corporation are liable to its creditors for any acts by which their rights are injuriously affected and for any loss arising out of their fraud. Through Appellees' bad faith conduct as directors of the corporation Snow Lines, Inc., they rendered the corporation insolvent and unable to satisfy its judgment debt. The total assets of the corporation, the moneys obtained from the sale of the M/V LEDA I, may be traced into the hands of Appellees for the satisfaction of that debt in favor of Appellants.

2. *Although Appellees' liability exists irrespective of statute, personal liability of Appellees for the judgment debt of the corporation is imposed by the law of*

Puerto Rico, and the Complaint sufficiently alleges facts which support Appellants' claims thereunder.

By December 3, 1959, when final judgment was rendered by the United States District Court for the District of Puerto Rico in favor of Appellants against the corporation Snow Lines, Inc., said corporation was but a hollow shell, engaged in no activity and devoid of any assets. By their disposal of the sole property of the corporation, Appellees, John P. and Ruth Snow Burns O'Rourke, as directors of Snow Lines, Inc., and the division of the proceeds of that sale between John P. and Ruth Snow Burns O'Rourke, as shareholders, which division of proceeds constituted an unauthorized return of capital to themselves as shareholders, Appellants' rights of recovery on their judgment against the corporation have been defeated. Had it not been for the transfer and distribution in which they engaged, plaintiffs could have satisfied their liquidated claim out of the corporate assets.

Under generally accepted conflict of laws rules such matters concerning, the internal affairs of a corporation as the rights and liabilities of shareholders and directors are generally governed by the law of the state of incorporation. Restatement, Conflict of Laws §§ 182 et seq., 192 et seq.; *Signal Oil Co. v. Ashland Oil Co.*, 49 Cal. 2d 764, 774, 322 P.2d 1 (1958); *Southern Sierras Power Co. v. Railroad Commission*, 205 Cal. 479, 271 Pac. 747 (1928); *Sarocco Tank Co. v. Platz*, 65 C.A. 2d 306, 150 P.2d 918 (1944); *Pratt v. Odell & Co.*, 49 C.A. 2d 550, 122 P.2d 684 (1942).

Appellants as creditors of the corporation Snow Lines, Inc. have a direct right of action against Appellees Ruth Snow Burns O'Rourke and John P. O'Rourke for their unlawful actions in reducing the capital of the corporation and distributing its assets and thereby rendering it insolvent and unable to pay the claim upon which it was obligated to Appellants.

Section 1804 of the Law of Private Corporations, Chapter 108, Title 14, 3A Laws of Puerto Rico (1962), provides the procedures whereby a corporation existing under the laws of Puerto Rico may reduce its capital, providing that

“... No such reduction, however, shall be made in the capital of the corporation unless the assets of the corporation remaining after such reduction are sufficient to pay any debts, the payment of which shall not have been otherwise provided for and the certificate shall so state.”

Section 1804(e) then provides:

“When any corporation shall decrease the amount of its capital as provided in this section, the certificate shall be published for three weeks successively at least once in each week, in a newspaper of general circulation published in this Commonwealth; the first publication to be made within fifteen days after the filing of such certificate, and in default thereof the directors of the corporation shall be jointly and severally liable to any creditors of the corporation who shall suffer loss by reason of the non-compliance with the provisions of this section and the stockholders shall be similarly liable up to the amount of such sums as

they may respectively receive of the amount so reduced. . . .”

The allegations of the complaint sufficiently asserted the joint and several personal liability of Appellees, imposed under Section 1804 of the Puerto Rico Law of Private Corporations, as directors of the corporation for the full amount of the loss suffered by the Appellants as judgment creditors of the corporation by reason of the failure of Appellees to comply with the provisions of Section 1804.

It was alleged in the complaint that Appellees Ruth Snow Burns O'Rourke and John P. O'Rourke, as directors and stockholders of the corporation, sold and conveyed the sole asset of the corporation and distributed the proceeds between themselves, and thereby rendered the corporation insolvent and without sufficient assets to pay the debt owed by the corporation to Appellants and that the payment of such debt was not otherwise provided for.

As stockholders of the corporation, defendants are also liable to plaintiffs under Section 1804, to the extent that they hold wrongfully distributed assets of the corporation, i.e., up to the amount of such sums as they have received by reason of the distribution between them of the amount realized from the sale of the corporation's sole asset.

Section 1521 of Title 14, Chapter 105, of the Laws of Puerto Rico provides for the imposition of liability on directors for an unlawful payment of dividends. This section reads in relevant part as follows:

“§ 1521. In case of any willful or negligent violation of the provisions of section 1520 of this title, the directors under whose administration the same may happen shall be jointly and severally liable, at any time within six years after paying such unlawful dividend, to the corporation and to its creditors, in the event of its dissolution or insolvency, to the full amount of the dividend unlawfully paid, with interest on the same from the time such liability accrued. . . .”

Section 1520 provides as follows:

“§ 1520. No corporation created under the provisions of this subtitle, nor the directors thereof, shall pay dividends upon any shares of the corporation except in accordance with the provisions of this subtitle. Dividends may be paid in cash, in property, or in shares of the capital stock, in the case of shares with par value at par, and in the case of shares without par value at such price as may be fixed by the board of directors.”

Section 1517 provides that dividends may only be paid out of available surplus or profits (net assets in excess of capital).

Unauthorized dividends include dividends not lawfully declared and also any illegal distributions of capital to stockholders, and the prohibition against unlawful payment of dividends applies regardless of whether any requisite formal action of the directors is observed in declaring the dividends, as where the stockholders of a corporation agree upon a distribution among the stockholders. See *Gray v. Sutherland*, 124 C.A.2d 280, 268 P.2d 754, 758 (1954); *Oilwell*

Chemical & Materials Co. v. Petroleum Supply Co.,
64 C.A.2d 367, 148 P.2d 720 (1944).

A situation similar to that in the instant case obtained in *Snyder v. Yoder*, N.D. Ohio, E.D., 176 F. Supp. 617 (1959), an action by a judgment creditor of a corporation against directors of the corporation for an unauthorized distribution of stock rendering the corporation unable to satisfy the judgment.

That action was dismissed because it was not brought within the period of the applicable statute of limitations under Ohio law, which then required that such an action against directors by a creditor must be brought within one year after final judgment was rendered against the corporation in favor of the creditor. As pointed out, *supra*, the applicable statute under Puerto Rican law is three years, the same as that under California law, CCP § 359. It was held in the *Snyder* case, however, that the actions of the defendants, as directors of a *de facto* dissolved corporation, in transferring and distributing assets which rendered the corporation unable to satisfy the plaintiffs' adjudicated claim were the basis for imposing personal liability upon the directors under an applicable Ohio statutory provision similar to section 1521 of the Private Corporation law of Puerto Rico set out above.

In brief, by distributing between themselves the total assets of the corporation Snow Lines, Inc., i.e., the proceeds from the sale of its sole asset, the ship M/V LEDA I, the defendants Ruth Snow Burns O'Rourke and John P. O'Rourke rendered the corpo-

ration insolvent in defraud of the plaintiffs as creditors of the corporation. By reason of their acts in making this unlawful distribution of the corporate assets, i.e., paying an unlawful dividend, and thereby reducing the capital to render the corporation insolvent, defendants committed statutory violations on the basis of which personal liability is imposed upon them under common law principles and under the statutes of Puerto Rico for the amount of the judgment debt upon which the corporation is obligated to the plaintiffs. Section 2202 of Chapter 112, Title 14 of the Laws of Puerto Rico, set out above, provides, however, that this personal liability as directors and shareholders could be asserted against Appellees only after a judgment has been obtained against the corporation.

This action is one directly against and based upon the personal liability of the Appellees, Ruth Snow Burns O'Rourke and John P. O'Rourke. The obtaining of a judgment against the corporation Snow Lines, Inc., was, under section 2202 of Title 14 of the Laws of Puerto Rico, a condition precedent to the maintaining of an action against the Appellees as directors and shareholders of the corporation, and a failure to allege such a judgment in the body of the complaint would be fatal to the assertion of a claim therein.

Such judgment had been obtained by the Appellants, and the statutory requirement thereby fulfilled for the bringing of this action, as alleged in the complaint filed below. Appellees are therein alleged to be separately and independently liable for the judgment debt upon which the corporation was obligated to the

Appellants. No relief is sought in this action against the corporation and it is in no way a real party in interest in the action.

D. Appellants' complaint alleged facts supporting the alternate theory that the corporate entity of Snow Lines, Inc., should be disregarded and appellees should be held personally liable on the judgment against the corporation.

The complaint filed in the court below alleged that the corporation Snow Lines, Inc., in fact never had and does not now have any separate or genuine corporate existence, but was "used by the defendants for the purpose of permitting defendants to transact a portion of their individual business under a corporate guise," and that the corporation had been used by appellees "for the sole purpose of defrauding the plaintiffs herein, who are creditors of said corporation."

The appellees Ruth Snow Burns O'Rourke and John P. O'Rourke owned practically all the stock (38 of 40 shares), were the controlling directors and were in fact the only persons interested in the corporation, which was used as their instrumentality solely for the purpose of operating the corporation's sole asset, the ship M/V LEDA I.

The general rule is that courts will disregard the corporate entity when it is shown that there is such a unity of interest and ownership that the separateness of the dominating or controlling individuals and the corporation has ceased, and when failure to disregard the entity would sanction a fraud or promote injustice, that is, when the facts demonstrate misuse

of the corporate privilege or the need of limiting it in order to do justice. See *Ruberoid Co. v. North Texas Concrete Co.*, 5 Cir., 193 F.2d 121, 122 (1951); *Minifie v. Rowley*, 187 Cal. 481, 487, 202 Pac. 673, 676 (1921).

The issue is not whether the corporate entity should be disregarded for all purposes, nor need it be shown that the purpose of organizing the corporation was itself fraudulent or to defraud the plaintiff, but rather the issue is:

“whether in the particular case presented and for the purpose of such case justice and equity can best be accomplished and fraud and unfairness defeated by a disregard of the distinct entity of the corporate form.” *Kohn v. Kohn*, 95 Cal. App. 2d 708, 718, 214 P.2d 71 (1950).

Appellants maintain that in the instant case, Snow Lines, Inc., is the mere alter ego of defendants John P. and Ruth Snow Burns O'Rourke, and that the corporate entity should be disregarded and the judgment against Snow Lines, Inc., should be enforced as a judgment against the defendants individually, and that it is sufficient to justify such disregard of the entity if its recognition would produce an inequitable result. *Riddle v. Leuschner*, 51 Cal.2d 574, 581, 335 P.2d 107, 112 (1959).

In a case involving identical issues to those herein on very similar facts, the Supreme Court of Puerto Rico held that a complaint seeking to enforce a judgment debt of a corporation against individual shareholders was not subject to dismissal. The Court stated:

“We are aware that a corporation has a legal personality independent of its stockholders. But if the corporation is the mere ‘alter ego’ or business conduit of its only stockholders, with the benefits produced by the corporate business accruing exclusively and personally to them, then the stockholders shall be personally liable if it is necessary to prevent fraud or the accomplishment of an illicit purpose, or to prevent an injustice or a wrong. 1 Fletcher, op. cit., § 41, pp. 136, 139, and cases therein cited; Ballantine on Corporations, § 123, p. 294; *Minifie v. Rowley*, 202 Pac. 673; *Gross v. Cohen et al.*, 58 So. 2d 703; *Laughran v. Reynolds*, 127 P.2d 586; *Davis v. Perry*, 120 Cal. App. 670, 8 P.2d 514; *Pickwick Corp. v. Welch*, 21 F. Supp. 664, 669; *Hollywood Cleaning and Pressing Co. v. Hollywood Laundry Service, Inc.*, 217 Cal. 124.

“Within the rule of liberal interpretation of complaints as pleadings, the situation pointed out above arises substantially from the allegations of the complaint before us. Naturally, if the corporate entity is to be disregarded in a particular case, such action would depend upon the circumstances in each case, in the light of the general rules set forth above, and should be decided by the trial court after weighing the evidence. *Stark v. Coker*, 129 P.2d 399. We are not anticipating the merits of this case, nor holding that this is an adequate case, in accordance with the reality of the facts, to warrant application of the ‘alter ego’ or ‘avoidance-of-fraud’ rule set forth above. We confine ourselves to deciding that the complaint, considered separately, states sufficient facts to serve as a basis for the decision

of the case on its specific merits.” *Cruz v. Ramirez*, 75 P.R.R. 889, 895-96 (1954).

CONCLUSION

It is submitted that the complaint filed by Appellants in the district court below contains sufficient allegations to invoke the jurisdiction of that court and to state a claim upon which relief may be granted, that appellees’ motions to dismiss the complaint pursuant to Rule 12(b)(1) and (6) should have been denied by that Court, and that the judgment of that Court dismissing the complaint should be reversed.

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I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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